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TO RUEHC/SECSTATE WASHDC PRIORITY 6831
INFO RUEHNE/AMEMBASSY NEW DELHI 8076
RUEHBI/AMCONSUL MUMBAI 2000
RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEAIIA/CIA WASHDC
RHEHAAA/NSC WASHINGTON DC
RUCPDOG/DEPT OF COMMERCE WASHINGTON DC
RHEHAAA/WHITE HOUSE WASHINGTON DC
RHMFIUU/DEPT OF ENERGY WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC

UNCLAS SECTION 01 OF 02 MUMBAI 000588

SENSITIVE
SIPDIS

DEPT PASS TO EXPORT-IMPORT BANK FOR JESSICA FARMER
DEPT PASS TO USTR AADLER/CLILIENFELD

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [ETRD](#) [EINV](#) [IN](#)

SUBJECT: RBI GOVERNOR SUBBARAO DISCUSSES THE INDIAN ECONOMY IN THE
WAKE OF THE GLOBAL FINANCIAL CRISIS

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11. (SBU) Summary. Speaking on a wide range of subjects, Reserve Bank of India (RBI) Governor Duvvuri Subbarao told the Consul General that he thought the global financial crisis would only slightly derail the high growth trajectory of the Indian economy. Acknowledging the problems in the Indian economy, he noted that credit conditions were tight, risk aversion was up, and inflation was still high. In addition, he expected that the RBI's monetary stimulus that would start to work after a normal time lag, and that foreign capital would begin to return to India. Speaking of the recent appreciation of the rupee from near all-time lows, he thought that the two-way movement of the currency was comforting. The Governor promised to look into U.S. Ex-Im Bank's Indian Infrastructure Facility proposal, and affirmed his commitment to review the state of the banking roadmap in 2009. End Summary.

Governor Reviews State of the Economy

12. (SBU) Reserve Bank of India (RBI) Governor Duvvuri Subbarao informed visiting Consul General and Congenoffs that he hoped that the Indian economy would quickly return to 8.5 percent GDP growth rates. He saw the financial crisis as only slightly derailing India's high-growth trajectory. He noted that a visiting International Monetary Fund (IMF) assessment team had projected that growth would decrease to 6.5 percent this year, and 5.8 percent in 2009. Subbarao did not challenge these projections, but stated that 8.5 percent GDP growth was required to halve poverty levels in a decade.

13. (SBU) Speaking directly about the financial crisis, Subbarao asserted that India had no direct exposure to sub-prime loans. Nevertheless, the effects of the crisis were being transmitted to India through the "financial, monetary, real, and confidence channels." In the financial channel, Indian corporations and banks have struggled to raise money overseas in recent months, increasingly credit demand in India. This borrowing has made it more difficult for Non-Bank Financial Companies (NBFCs) and mutual funds to raise money domestically. The main "hiccup" now, he said, was the crisis in confidence, which he believed to be "temporary and shallow." Demand for credit, risk aversion, and the cost of funds had all increased in the current environment. He stated that inflation was still high, at eight percent, which made it difficult to lower deposit rates. He explained that Indian banks wished to lower deposit rates, but

feared savers would move money to other outlets and savings programs if rates were lowered any more. He added that as the crisis deepens in the developed world, the effect on India could worsen.

Monetary Stimulus Will Work After a Normal Delay

14. (SBU) Describing the RBI's response to recent financial events, Subbarao explained that the central bank had increased liquidity "beyond comfort levels" to ensure banks had enough money to lend. Noting that monetary policy signals in developing countries took longer to impact the economy than signals in developed countries, he acknowledged that the real economy in India had not felt the effects of the monetary stimulus due to the time lag.

Rupee's Two-Way Movement Is "Comforting"

15. (SBU) After several months of depreciation, the RBI Governor described the "two-way movement" of the rupee as "comforting." He believed the appreciation was due to the downward movement of the dollar, rather than a strengthening rupee. He reminded the Consul General that global risk aversion had caused the dollar to appreciate, as investors sought safety. However, investors now appeared concerned about the U.S. economy, where the uncertain impact of the fiscal stimulus and problems in the auto industry had changed investor sentiment. He said the RBI "takes no position" on the rupee's value, and works only to "smooth" the direction of the currency. He informed the Consul General that exporters would normally be happy with a weak rupee, but so many had hedged their dollar exposures earlier this year at Rupees 40 to a dollar that they were taking losses because of the depreciation.

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Trade Finance Constraints are Not as Bad as Thought

16. (SBU) Subbarao stated that the RBI was aware of constraints in obtaining trade finance. The central bank's research shows that the stock of trade finance is down and the cost of such finance is rising. However, he cautioned that the problem is not as bad as many thought. He added that he did not know of specific companies having problems in obtaining trade finance.

U.S. Export-Import Bank and External Commercial Borrowing

17. (SBU) The Consul General briefed Subbarao on the U.S. Export-Import Bank's (Ex-Im) India Infrastructure Facility (IIF), and the proposal for Indian banks to co-guarantee loans to Indian borrowers. Subbarao responded that he did not know the specific problems with the Ex-Im facility. He explained that RBI policy is that foreign lenders should take the full risk of the loan to an Indian borrower without the intermediation of an Indian bank. However, noting the Indian government's prioritization of the infrastructure sector, he promised to look into this issue. Subbarao also promised to examine the case of the Bhopal Medical College Private Ltd., whose application for a loan from Ex-Im still awaited approval. (Note: The Consul General provided Subbarao with a four-page briefing note about the IIF. End Note.)

18. (SBU) Speaking more generally about External Commercial Borrowing (ECB), Subbarao stated that he wanted more ECBs and Non-Resident Indian (NRI) money to come, but he had not seen any sign that this was happening. He opined that once things calm down globally, India will again be a good destination for foreign capital. He added that he did not believe the central bank had liberalized ECB policy too much.

Global Events Delaying Banking Roadmap

¶9. (SBU) On the topic of India's banking roadmap, the Governor said he was "deeply conscious" of the government's promise to review the banking sector in 2009. He had started thinking about it the day that he took office, but his focus was diverted by global financial events, such as the troubles at Freddie Mac and Fannie Mae that started to affect global credit markets. As a result, the issue has remained at the back of his mind, though he acknowledged the importance of the subject.

Mumbai Will Bounce Back Quickly after Terrorist Attacks

¶10. (SBU) Turning his attention to Mumbai's future after the recent terrorist attacks, the central bank governor thought the city would bounce back quickly like New York City after the attacks of Sept. 11, 2001. He opined that people in Mumbai must return to normal quickly, as they cannot survive financially if they stay home. According to Subbarao, the attacks will only have a limited impact on economic activity.

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